

Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Cardenas Analyst: Jeff Garnier Bill Number: AB 1923
 Related Bills: See Legislative History Telephone: 845-5322 Amended Date: 2/15 & 3/27/00
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Care Facility Credit/50% of Costs for Facilities Serving Low-Income Children/Bank Loans Credit/FTB Report to Legislature Upon Request

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit in an amount equal to 50% of qualified expenditures and not to exceed specified limits, to any taxpayer that pays or incurs monetary contributions for costs of any new licensed child care facility or expanded existing child care facility located in California. This bill also would allow the proposed credit to reduce regular tax below tentative minimum tax (TMT).

Under the B&CTL, for specified loans relating to financing qualified child care and development facilities, this bill would allow a credit equal to 50% of the difference between the amount of interest income actually received and the amount of interest income that would have been received had the loan been made at one point above the prime rate.

This bill would require a report to the Legislature upon request regarding the total amount of credits claimed under this provision.

These provisions will be discussed separately.

SUMMARY OF THE AMENDMENT

The March 27, 2000, amendment would provide that a child care provider could not qualify for the credit. The amendment also specifies that only monetary contributions could qualify as a qualified expenditure. The amendment also changed the carryover period for the credit from five years to six years. The amendment further provides that an in-home family child care or licensed exempt care facility could not qualify as a qualified child care facility. Finally, the amendment clarifies the requirements of the child care provider certification and makes several other technical corrections.

1. CHILD CARE FACILITY CREDITEFFECTIVE DATE

This provision would be effective immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 2000, and before January 1, 2005.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> X </u> PENDING

Department Director

Date

Gerald H. Goldberg

5/2/00

LEGISLATIVE HISTORY

SB 549 (1999) proposed to expand the existing Child Care Facility Credit to include taxpayers who contribute costs for low-income facilities; the bill failed passage in Senate Appropriations. AB 401 (1999/2000) proposed to remove the sunset date of the Employer Child Care Contribution Credit and allow a credit for child care expenses; the bill failed passage in Assembly Revenue and Taxation.

SPECIFIC FINDINGS

Existing federal and state law provide for an alternative minimum tax liability, which ensures that taxpayers with credits, deductions, and other tax preference items do not completely escape taxation.

Existing state law allows employers a tax credit known as the Employer Child Care Program Credit. This credit equals 30% of the cost paid or incurred for (1) establishing a child care program or constructing a child care facility in California to be used by employees' children and (2) contributing to child care information and referral services. Building owners are allowed a credit equal to 30% of their costs to establish a child care program or facility to be used by their tenants' employees' children. The amount of the credit is limited to \$50,000, even if 30% of the taxpayer's expenses exceed \$50,000. To the extent that the allowed credit cannot be used, a credit carryover is permitted. The carried-over amount may be added to any credit for that succeeding year, which is still limited to \$50,000.

Existing state law allows employers a tax credit known as the Employer Child Care Contribution Credit. The credit is equal to 30% of the cost paid or incurred for contributions to a qualified care plan made on behalf of any dependent under the age of 12 of the taxpayer's California employee, but only to the extent contributions are made directly to child care programs or providers. The amounts paid by the employer to child care providers can be in lieu of wages paid to the employees. The amount of the credit cannot exceed \$360 in any year for each qualified dependent, and any unused credit may continue to be carried forward, even beyond the repeal date, until it has been exhausted.

This bill would allow a credit in an amount equal to 50% of "qualified expenditures," not to exceed specified limits, to any taxpayer that pays or incurs monetary contributions in excess of \$4,000 to a "qualified child care facility" located in California. The credit would apply in taxable or income years beginning on or after January 1, 2000, and before January 1, 2001.

Qualified child care facility would mean any new or expanded existing licensed child care facility located in California. It excludes in-home family child care or licensed-exempt care. A licensed child care facility also excludes a facility located in an occupied personal residence. "Child care provider" is defined as the licensed owner or operator receiving the benefit of the contribution to the qualified child care facility but who is ineligible for the credit.

This bill would be require the "child care provider" to certify that a written plan has been developed and maintained. The plan must reflect the child care provider's ability to recruit children from low-income families.

The term low-income families means households that have incomes below 75% of the local area median income, as published by the U.S. Department of Housing and Urban Development or as defined by the State Department of Education. The child care provider must also certify that either:

- the child care provider has applied for or received approval to accept children from families qualifying for child care subsidies, or
- the child care facility is or will be geographically located in or within one mile of a low-income area as defined by the Community Reinvestment Act of 1977, as amended.

The bill would define "construct" or "expand" to include, but not be limited to, feasibility studies, site preparation, construction, renovation, or acquisition of facilities for purposes of establishing a new licensed child care facility or expanding an existing licensed child care facility that adds new child care capacity.

This bill would also require the taxpayer to provide a statement from the child care provider certifying that the monetary contributions were used to construct or expand a child care facility in California to be used as certified by the provider.

The bill would define qualified expenditures to include only monetary contributions made by a qualified taxpayer that do not exceed either \$400,000 for any single qualified child care facility or \$2 million in aggregate contributions for multiple qualified child care facilities. The \$400,000 and \$2 million maximums are cumulative and include amounts contributed in prior taxable or income years. The maximums also would include qualified expenditures made by any party related (as defined in IRC sections 267 or 318) to the taxpayer.

This bill would provide that a taxpayer could not utilize more than \$150,000 of the credit in any single taxable or income year. If the credit exceeds the \$150,000 annual limitation or exceeds net tax, any excess credit may be carried over for six succeeding years and applied on a "first-in, first-out" basis. The aggregate "allowable child care facility credit" for each taxpayer and any party related to the taxpayer for the taxable years the credit is authorized cannot exceed \$1 million.

This bill would provide that a deduction would not be allowed, as may be provided elsewhere in the Revenue and Taxation Code, for the portion of the qualified expenditures equal to the credit allowed by this bill. Additionally, no credit would be allowed to a taxpayer that is required by a local ordinance or regulation to provide a child care facility.

This bill also would include the proposed Child Care Facility Credit in the list of credits that can reduce regular tax below tentative minimum tax for purposes of alternative minimum tax calculation.

Policy Considerations

Although this bill suggests that a child care provider is required to certify use of the qualified child care facility, no particular use of the facility is required.

Consequently, a qualified taxpayer would be eligible for this credit regardless of whether child care is actually provided. A child care provider could provide the certifications required to be obtained by the taxpayer and not actually provide child care to low-income families or at all. The author may wish to consider requiring that a minimum percentage of low-income families actually receive services from the facilities to qualify for the credit. The bill should require the child care provider to maintain documentation of the income of the families' of registered children.

This bill does not require the child care facility to be operated for a minimum amount of time. A child care facility could be built and never opened or operated for only one day, and then be converted to another use. Under these facts it is arguable that the taxpayer would still qualify for the credit. If a minimum time period is added to the bill, a credit recapture provision should also be considered.

While the bill specifies that the credit is not available to a child care provider, nothing in the bill precludes a partner in a partnership that owns and operates a child care facility from making a contribution to that facility and claiming the credit.

The bill does not quantify "expand" or "expanding" of an existing licensed child care facility. Expanding only requires that "new child care capacity" be added. An extensive renovation that increases only the ranges of ages of children receiving care in the facility could be considered to add child care capacity. Although there would be no increase in the number of children actually receiving child care, amounts contributed for the renovation could qualify for the credit.

Implementation Considerations

It is unclear if the taxpayer would still be entitled to the credit if it were later determined that the certifications provided by the child care provider were incorrect.

Several terms, including "child care facility", "in-home family child care", "licensed exempt care", "qualified child care provider", and "new child care capacity" are undefined. Undefined or unclear terms lead to disputes between taxpayers and the department and complicate tax administration.

Technical Considerations

This bill requires the child care provider to furnish a statement for the taxpayer certifying that the costs for which the credit is claimed were incurred to construct or expand a child care facility. However, the credit is based on contributions made by a taxpayer. To avoid confusion, the author may wish to change the phrase to "the contributions for which the credit is claimed were expended".

2. CREDIT FOR INTEREST INCOME ON CHILD CARE AND DEVELOPMENT FACILITIES

EFFECTIVE DATE

This provision would be effective immediately upon enactment and would apply to income years beginning on or after January 1, 2000, and before January 1, 2010.

SPECIFIC FINDINGS

Existing state law allows a similar credit for interest income on loans used to finance qualified expenditures for farmworker housing (except that expenditures do not include the cost of acquiring a building or structure). **Existing state law** also allows taxpayers that make loans to businesses within an Enterprise Zone to deduct net interest.

Existing federal law taxes interest on federal obligations (e.g., bonds issue by the federal government) and allows the imposition of a state tax on that interest if the state tax is nondiscriminatory. (The tax imposed on the federal interest is not different than tax assessed on other interest.) **Under existing state law** interest on state obligations (e.g., bonds issue by a state) and interest on federal obligation are exempt from personal income tax but are included within the measure of the corporate franchise tax.

This bill would allow a credit for 50% of the difference between the interest income received on loans, or the portions of loans, used to finance the purchase, construction, expansion or rehabilitation of qualified child care facilities, and the interest that could have been received had the loan rate been one point above the prime rate.

The credit allowed by this provision shall be claimed in equal installments over a period equal to the lesser of 10 years or the term of the loan. The period would begin in the taxpayer's first income year which the qualified child care facility construction, expansion, or rehabilitation is completed and the initial enrollment of children. In the case where this credit exceeds the taxpayer's tax liability, the excess may be carried over until the credit is exhausted.

The credit shall not apply to loans with a term of less than three years or to loans funded prior to January 1, 2000. The credit shall apply only to interest income from the loan and shall not apply to any other loan fees or other charges collected by the bank or financial corporation with respect to the loan.

"Qualified child care or development facility" is defined as a licensed child care or development facility that:

- Is operated by child care providers that agree as a term of a loan from a bank or financial institution to provide child care services for the entire term of the loan;
- and meets one of the following additional requirements:
 - Is located in low- or moderate-income areas as defined by the Community Reinvestment Act of 1977 (Public Law 95-128), as amended; or
 - Is operated by child care providers that covenant with the banking or financial institution that not less than 30% of the children served by the facility will be from households with incomes at or below 75% of the local median income as published by HUD.

Family day care centers are not qualified facilities.

This credit shall not apply to loans for purchasing land or for refinancing existing loans.

The credit would be disallowed for any year after the occurrence of a disallowing event. A disallowing event occurs if the child care provider 1) defaults on payment of a loan for more than 90 days, 2) ceases providing child care at the facility for more than 90 days or 3) falls below the requisite 30% of the children served are from households with incomes at or below 75% of the local median income .

The credit may not be claimed for any project receiving funding or subsidy from the Child Care and Development Facilities Loan Guaranty or Direct Loan Funds, as contained in Sections 8277.5 and 8277.6 of the Education Code.

Generally, if the bank or financial corporation sells the loan to another bank or financial corporation, the balance of the credit, if any, shall be transferred to the assignee or transferee of the loan, subject to the same conditions and limitations of the credit. A bank or financial corporation may assign, sell, or otherwise transfer the loan to another person or entity and retain the right to claim the credit granted under this section if the bank or financial corporation retains responsibility for servicing the loan.

Policy Considerations

This credit is attempting to encourage building and improving child care centers for low income registrants by providing an incentive to lenders and taxpayers over the life of a loan made for this purpose. As drafted, the language provides that behavior of the borrower affects the lender's ability to take the credit. The lender would have to demonstrate compliance by the borrower if audited. This may diminish the incentive to the lender to make such loans.

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations for interest forgone on loans relating to child care and facilities. This could be interpreted to subject interest on federal obligations to a discriminatory state franchise tax in violation of federal law.

Implementation Consideration

As indicated under Policy Considerations above, the bill would disallow the credit based upon the occurrence of certain behavior of a borrower. The occurrence of a disallowing event would be extremely difficult to determine.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this bill is not expected to impact the department's costs.

Tax Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follow

Estimated Revenue Impact			
Taxable/Income Years Beginning On or After January 1, 2000			
Enactment Assumed After June 30, 2000			
Fiscal Years			
(In Thousands)			
	2000-1	2001-2	2002-3
Facility Credit	-\$700	-\$900	-\$1,100
Interest Income Credit	Negligible	Minor	Minor

Negligible = Loss less than \$250,000.
Minor = Loss less than \$500,000.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

Facility Credit:

Revenue losses would depend on the amount of new cash contributions and redirected cash contributions of at least \$4,000 per contributor. For purposes of this estimate, it is assumed that contributions will be redirections of amounts usually given to other charitable organizations that are deductible for income tax purposes, or trade or business expenses for employers making contributions for the benefit of employees.

The number of child care centers qualifying under this provision is projected to be 95% of the total new or expanded non-government, for profit centers in California, i.e., 442 centers in 2000. The projected growth rate for centers increases from 4% in 1998 to 8% in 2003, due to factors such as welfare reform, increased funding from the California Department of Education, the increasing demand for child care in California, and the incentive effect of this provision. These factors were also considered in the estimate for centers that will expand existing facilities. The lack of a recapture provision may induce some taxpayers to take advantage of the tax credit without actually operating a child care facility on an ongoing basis.

Of the projected 442 new or expanded qualified child care facilities in 2000, it is assumed that 25%, or 111 facilities, will receive three cash contributions averaging \$5,000. The total projected 2000 contribution after the 50% credit limitation is \$829,000. The 2000 offset is projected to be \$133,000, resulting in a 2000 liability year revenue loss of \$700,000.

Estimates were developed in coordination with child care system and facility experts at the National Economic Development and Law Center and the California Child Care Resource and Referral Network.

Interest Income Credit:

This estimate is provided as a rule of thumb for every \$50 million in annual qualified loans and assumes an average loan term of 7.5 years with an average discount rate of 1%.

LEGISLATIVELY MANDATED REPORTS

The FTB would be required to report to the Legislature, upon request, the total amount of tax credits claimed under this provision, and the number, type, and income level of taxpayers claiming the credits. The FTB shall also report the industry classification of corporate taxpayers claiming the credits.

BOARD POSITION

Pending.